



**STATE INVESTMENT BOARD  
BOARD ADOPTED POLICIES**

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**POLICY NUMBER:** 2.14.100

**EFFECTIVE DATE:** 10/25/01

**TITLE:** Horizon Funds

**SUPERSEDES:** 2.60.100, 7/20/00

**BOARD ADOPTION:** 7/20/00

**APPROVED:** *James F. Parker*

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**PURPOSE:**

To create the "life style" balanced funds under the management of the State Investment Board (SIB) and enumerate the participants who may invest in those funds.

The document formulates the Board's policies and guidelines on: 1) number of funds; 2) investment strategy for each specific investment fund; 3) daily management of the funds; and, 4) monitoring and evaluating the performance of the balanced funds.

**BACKGROUND:**

The SIB has been named trustee of the assets of the Deferred Compensation Program (RCW 41.50.780), Teachers Retirement System Plan 3 [TRS 3] (RCW 43.33.190), and School Employees Retirement System Plan 3 [SERS 3] (RCW 41.34.120). RCW 41.34.130 and RCW 41.50.088 further directs the SIB, after consultation with the Employees Retirement Benefit Board (ERBB), to provide self-directed investment options for these programs. Subsequently, the ERBB has requested "life style" balanced funds be made available with the implementation of SERS 3 on September 1, 2000. Furthermore, through an interagency agreement, the Office of the Administrator for the Courts has requested that the SIB provide investment management, investment oversight, and investment options for the Judges Retirement Account (JRA), and to perform certain trustee functions related to the assets.

The SIB reviewed numerous options for balanced funds, focusing in on the investment philosophy of firms offering the funds, the number and variety of options available, consistency of performance, and, finally, costs. The SIB concluded that the participants would benefit from the formation of internally managed options. The balanced funds would be structured to match the SIB's philosophy on the benefits of passive management on certain asset classes, and receive the cost benefits of contracts negotiated for all the sizeable SIB assets. The options would also be structured to appeal to a diverse collection of public employees and would be consistent across all participant groups.

**POLICY:**

**Standard of Care**

The Legislature has established a standard of care for investment of all SIB funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics in Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions.

**Investment Objectives**

In accordance with RCW 43.33A.110, the portfolio is managed to achieve a maximum return at a prudent level of risk. The risk levels are determined by the investment objectives for the portfolio and anticipated participant's investment horizon:

- A. Short-Horizon – stability and current income
- B. Mid-Horizon – growth
- C. Long-Horizon – aggressive growth

The three portfolios have the following common objectives:

1. Exceed the rate of inflation.
2. To be efficiently managed so that the individual portfolios produce returns that track the target portfolio.
3. To be cognizant of the liquidity needs to effect daily cash withdrawals and daily pricing of the portfolio.
4. To be invested in a manner that does not compromise participant and public confidence in the investment option.

**Participants**

Any participant of a self-directed retirement plan created by the state may own units of the balanced portfolios.

### **Portfolio Options**

Current theory allows that there are three basic stages of a person's saving cycle:

**Accumulation Phase** – Typically described as the initial stage of a person's investment cycle where they have little or no accumulated wealth. Investment theory concludes that a person in this phase should primarily be interested in capital growth and have a high tolerance to risk.

**Transitional Phase** – Typically a person in this phase is nearing retirement age and has accumulated the majority of his/her retirement wealth. Investment theory concludes that a person's risk level is starting to lower as stability of assets and current income are starting to enter into the equation along with capital appreciation.

**Spending Phase** – Typically a person in this phase has retired and is living off of their retirement assets. Investment theory concludes that the focus is now on stability of principal and current income with capital appreciation needed primarily as an inflation protection.

While acknowledging that the following funds may not meet the needs of all individuals, the Board has resolved to create three portfolios that match the diverse needs of the participants.

Washington State Investment Horizon Funds:

Short-Horizon

Mid-Horizon

Long-Horizon

### **Investment Strategies**

The Board recognizes that selection of asset classes, the amount invested in each, and the mix among these is the greatest source of return and risk to a portfolio. Therefore, the apportionment and management of the asset allocation is the foundation of the investment program and crucial to its success. The asset allocation, when viewed along with the investment policies in each asset class, constitutes the Board's view of a prudent and well-reasoned approach to the management of the entrusted assets.

With this in mind, the Board has elected to use four asset classes in the creation of the balanced portfolios: domestic equities, international equities, fixed income securities, and cash. Using an optimization model, the Board has derived the following asset allocation targets:

	<u>Short-Horizon</u>	<u>Mid-Horizon</u>	<u>Long-Horizon</u>
Domestic Equities	19%	38%	58%
International Equities	10%	16%	22%
Fixed Income Securities	46%	46%	20%
Cash	25%	0%	0%

SIB staff will attempt to maintain the asset target within a band of plus or minus five percent, with the exception of periods of significant market disruption or volatility and during the first year of operation where the asset classes may range from zero to 100 percent. It is the intent of the SIB to maintain target levels. The SIB, recognizing that the capital markets are dynamic and fluid and that participant cash flows are uncertain, understands that the actual portfolios may deviate from the target levels for a period of time. Staff will review the allocations regularly and will rebalance as warranted.

The SIB has determined that the participants would best be served, taking into consideration tracking error and costs, using broad-based commingled funds for the individual components:

Domestic Equities	Wilshire 5000
International Equities	EAFE
Fixed Income	Lehman Intermediate Credit Index
Cash	One month LIBOR

Capital markets and market conditions are dynamic, not static. Therefore, the asset allocation targets and component composition will be reviewed every three to five years to ascertain that the funds are structured appropriately.

### **Management of the Funds**

The funds will be managed, rebalanced, priced and unitized in commingled funds. The funds will be managed by the SIB staff.

1. Participants will have the option to buy or sell units on a daily basis. The fund reserves the right to suspend purchases or sales of unit shares when forces beyond the control of the SIB prevent the pricing of the fund.
2. Underlying components will determine Net Asset Values (NAVs) on a daily basis net of manager fee. Striking of each fund unit price will be calculated using the best information available at the time and the unit price will be communicated to the record keepers daily.
3. The rebalancing decision will be based on the requisite need to maintain target levels and be managed in a cost-efficient manner, accomplished primarily through participant contributions and withdrawals.

## **INVESTMENT PERFORMANCE:**

### **Performance Measurement**

Performance will be measured twofold:

1. The managers of the underlying components of the funds will be measured against their assigned benchmark; and,
2. The total fund will be compared against the target allocation return.

### **Reporting**

Internal reporting to senior staff on a monthly basis shall include, but not be limited to:

1. Current market values and allocation by asset class; and,
2. Cash flows of the participants.

SIB staff will prepare a quarterly executive management report for the SIB Board and the ERBB.

## **RESPONSIBILITIES:**

State Investment Board - Responsible for creating and approving the target asset allocations for the three horizon funds and for monitoring the performance of those funds.

Public/Private Markets Committees - Responsible for structural investments within the asset allocation policy (and appropriate asset class policies) and assisting with allocation management as indicated above.

Staff - Responsible for reviewing the asset allocation daily, monitoring cash flows and rebalancing to the targets, as warranted, calculating daily NAV's and accounting for aggregate shares for participant groups. Responsible for implementing and maintaining policy and reporting to the SIB Board and the ERBB.